



State of Washington  
Department of Revenue

# Excise Tax Advisory

---

Excise Tax Advisories (ETA) are interpretive statements issued by the Department of Revenue under authority of RCW 34.05.230. ETAs explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts. They are advisory for taxpayers; however, the Department is bound by these advisories until superseded by Court action, Legislative action, rule adoption, or an amendment to or cancellation of the ETA.

---

NUMBER: 414.04.109/170

CONVERSION DATE: July 1, 1998

---

## AMOUNTS PAID UNDER A PENALTY CLAUSE

Revised: March 1, 1993

This Excise Tax Bulletin explains the Department's position on the effect penalty clause payments have on the measure of tax liability of a contract. This is a clarification and not a change in the Department's position.

Contracts often contain penalty clauses which may be invoked if the contractor fails to complete a contract, or portion thereof, by a specified date. In these situations, the contracting party generally withholds the amount of the penalty from the contract proceeds due the contractor. Does the penalty reduce the measure of the retail sale?

It is the Department's position that penalty clause amounts paid by, or withheld from, a contractor are not adjustments to the gross contract price. These amounts represent losses incurred by the contractor due to its failure to provide required services and/or products by a specified date, and are considered costs of doing business.

The business and occupation and retail sales taxes are imposed on the gross income of the business, or selling price. These terms are defined very broadly by statute, with no allowance for the deduction of costs or expenses incurred by the seller. On the other hand, the payment of a bonus to the contractor for early completion is additional consideration in respect to the construction contract. The bonus is subject to B&O tax and also retail sales tax when the construction is a retail activity.

As costs of doing business, penalty clause losses may not be deducted from the gross contract price when determining the measure of tax liability.

---

***ETBS have been made Excise Tax Advisories, and have retained their old number. Advisories with a 2 (plus three digits) are new advisories, ETBs that have been revised and readopted after review under the Department's regulatory improvement program, or advisories that have been revised and/or readopted.***

**To inquire about the availability of receiving this document in an alternate format for the visually impaired or language other than English, please call (360)753-3217. Teletype (TTY) users please call 1-800-451-7985.**

---

Please direct comments to:  
Department of Revenue  
Legislation & Policy Division  
P O Box 47467  
Olympia, Washington 98504-7467  
(360) 753-4161 eta@DOR.wa.gov